52-SBE-006

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
INLAND DEVELOPMENT CORPORATION)

Appearances:

For Appellant: David Uzel, Certified Public Accountant

For Respondenf: Burl D. Lack, Chief Counsel

O E IN I _ON

This appeal was made pursuant to Section 27 of the Bank and Corporation Franchise Tax Act (now Section 26077 of the Revenue and Taxation Code) from the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) in denying the claim of Inland Development Corporation for a refund of tax and interest in the amount of $14,335.77 for the taxable year ended June 30, 1948.

Appellant's organizers executed a pre-incorporation agreement on July 1, 1946, and commenced activities pursuant to this agreement on that date, Its articles of incorporation were filed with the Secretary of State on July 24, 1946. Appellant filed its first franchise tax return for the period beginning July 1, 1946, and ending June 30, 1947, including in the return its operations for the period from July 1, 1946, to July 24, 1946, and paid the minimum tax of $21.25.

Proceeding upon the *theory* that its first year was a period of 12 months, within the meaning of Section 13(c) of the Franchise Tax Act, the return filed by Appellant for the taxable year July 1, 1947, to June 30, 1948, also reflected its operations for the period ended June 30, 1947, and was accompanied by a payment of the minimum tax, The Commissioner concluded, on the other hand, that the first taxable year was not a period of 12 months and that the tax for the second taxable year, that ended June 30, 1948, should be based on the income of that year under Section 13(c). Following the payment of the additional assessment resulting from this determination, the taxpayer filed the refund claim which is the subject of this appeal,

We are of the opinion that the action of the Commissioner must be upheld, While the Appellant presents a wide variety of arguments in support of its position, they boil down to the contentions that it had a de facto existence between July 1, and 24, 1946, that by reason of its activities or those of its organizers on its behalf during that period it became subject to the franchise tax or the corporation income tax on

July 1, 1946, and that under subdivision (c) or (d) of Section 13 of the Act its franchise tax for the taxable year ended June 30, 194.8, should be measured, accordingly, by its income for the year ended June 30, 1947.

Appellant's position as to its status as a de facto corporation between July 1 and 24, 1946, must be rejected. As conceded by Appellant, the minimum requisites to attain that status are (1) a law under which the corporation could be lawfully organized, (2) a bona fide attempt to organize thereunder, and (3) an actual use of the corporate franchise. Midwest Air Filters Pacific, Inc. v. Finn, 201 Cal, 587; Westlake Park Investment Co, v. Jordan, 198 Cal. 609. Appellant has failed, however, to present any evidence establishing its compliance with the second and third of these requisites. It has not shown that at any time between the execution of the pre-organization agreement of July 1, 1946, and July 24, 1946, it purported to or did act in a corporate capacity under a franchise, valid or otherwise, or that it exercised any of the powers granted to corporations, In fact, that agreement is phrased in terms of the contemplation of the parties to organize a corporation and commits them to cause a corporation to be formed and clearly indicates, accordingly, that the signers had no intention of organizing or acting as a corporation until a later date.

In support of its contention that its first taxable year was a full 12 months within the meaning of the Franchise Tax Act, Appellant cites Camp Wolters Land Co. v. Commissioner, 160 F. 2d 84. It is quite true that the Court held therein-that a corporation was entitled to a deduction for a loss occurring in a pre-incorporation period during which its promoters were acting on its behalf and in its name and that in the annualization of the excess profits tax the entire period, including the pre-incorporation period, in which the income taxed to the corporation was in process of production, should be used. It should be observed, however, that there is only very slight similarity between the pre-incorporation activities of the promoters in that and the instant case. There the promoters over a period of almost four months purchased and leased lands from third persons, purchased and removed improvements from lands, sold the improvements, leased land to a city, borrowed money, and in the course of these activities collected rent, made bank deposits and wrote checks - all in the name of the corporation. Here, the activities of the promoters of Appellant over a period of 24 days related to the annexation of land to a city, the recording of subdivision maps and other preliminaries to the development of land already owned by a partnership consisting of Midland Properties, which subscribed to one-half the stock originally owned by Appellant, and Halper Construction Company of which L. M. Halper, who subscribed to the remaining half of the stock, was a stockholder. Furthermore, there has not been a showing here that the activities of the promoters were carried on in the name of the corporation, as they were in the Camp Wolters case. To the contrary, the pre-incorporation agreement and Appellant's allegations indicate that activities of the promoters prior to

July 24, 1946, were merely for the benefit of or on behalf of the corporation to be formed. The length of the period during which the pre-incorporation activities were conducted, the nature of those activities and the manner in which they were conducted, and the fact that in the Camp Wolters case the activities related to property with which the promoters had no previous connection whatever whereas in the instant case the property was for the most part owned directly or indirectly by the promoters, who would reap the benefits of those activities even though the corporation were not formed, render that case of little persuasive force here.

The two cases are also dissimilar from the standpoint of the type of tax law involved. The Camp Wolters decision concerned the application of the federal income and excess profits taxes, the issue being whether the profits and losses in question were properly to be regarded as those of the corporation, its promoters acting as partners or an association taxable as a corporation. Here, we are concerned not with the application of an ordinary tax on net income, but rather with a tax imposed on a corporation for the privilege of exercising its corporate franchise within the State. In the Appeal of Ornitz (May 17, 1950) we held that the first taxable year of the corporation there involved began with the date of filing of its articles of incorporation with the Secretary of State and pointed out that "The tax is not on the mere doing of business but rather on the privilege of doing business as a corporation. It is imposed on the privilege of using the corporate mechanism, with its consequent advantages over other forms of doing business in this State. Edward Brown & Sons v. McColgan, 53 Cal. App. 2d 504, 508." In view of these considerations, the Camp Wolters decision cannot, in our opinion, be regarded as determinative of this appeal.

Even if Appellant were subject to tax under the Corporation Income Tax Act for the period July 1 to 24, 1946, as it contends, it would not be entitled to a refund as its tax liability for the period involved would be unchanged. Under Section 13(d)(2)(B) of the Franchise Tax Act its tax for the taxable year in question (its second taxable year) would then be measured by the income of that taxable year. Its argument that the phrase "that taxable year" in Section 13(d)(2)(B) refers to the year it commenced to do business, i.e., the year ended June 30, 1947 (its first taxable year) is not only inconsistent with the language of the statutory provision, but is shown to be erroneous by subparagraph (D) of that Section. If Appellant's position were correct, the return of income for the year in which a corporation which has been subject to the corporation income tax becomes subject to the franchise tax would be the basis for the tax for that year and also for the following year (its second taxable year under the Franchise Tax Act). Subparagraph (D) of Section 13(d)(2), however, requires a return to be filed for the corporation's second and third taxable years following the close of its second taxable year. Quite obviously, unless the tax for the second taxable year is to be measured by the income for that year, it would serve no purpose whatever to require a

return for the second taxable year after the close of that year.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 26077 of the Revenue and Taxation Code (formerly Section 27 of the Bank and Corporation Franchise Tax Act), that the action of the Franchise Tax Commissioner (now succeeded by the Franchise Tax Board) in denying the claim of Inland Development Corporation for a refund of tax and interest in the amount of $14,335.77 for the taxable year ended June 30, 1948, be and the same is hereby sustained,

Done at Sacramento, California, this 29th day of May, 1952, by the State Board of Equalization.

; Chairman
Wm. G. Bonelli, Member
J. H. Quinn, Member
Geo. R. Reilly, Member

ATTEST: Dixwell L. Pierce, Secretary